

JANUARY/FEBRUARY 2005

CALIFORNIA FRANCHISE TAX BOARD

# Tax News

## Amnesty begins Feb. 1, 2005

California's 2005 tax amnesty program offers a window of opportunity for business entities and individuals to pay their past-due income or franchise taxes and interest, and they will not have to pay most penalties and fees or fear prosecution. Tax amnesty ends March 31, 2005. If they choose to take advantage of this limited time program, they can correct tax records and save money. We will waive most penalties and fees applicable to taxable years beginning before January 1, 2003. Log onto our Website at [www.ftb.ca.gov](http://www.ftb.ca.gov) for the most current and comprehensive information about this opportunity. Keyword: *Amnesty*.

### Download your own tax amnesty posters

Help spread the word about California's tax amnesty program and possibly generate new business at the same time. Go to our Website at [www.ftb.ca.gov](http://www.ftb.ca.gov) and click on the amnesty logo to find out how you can download, for free, full color amnesty images and posters for use in your office or Website. Keywords: *Amnesty posters*.

CALIFORNIA  
COUNTS  
ON YOU!



TAX AMNESTY  
ENDS MARCH 31

## FTB creates new hotline for reporting tax shelter abuses

The tax practitioner community is one of our greatest allies in the fight against abusive tax avoidance transactions. That's why we are asking for your full cooperation to help end these abuses. Any information you have that may assist in the detection of and enforcement against abusive tax avoidance transactions can be provided confidentially by calling the hotline number at (916) 845-4300 (Monday through Friday, 7:30 a.m. until 5 p.m.). You can give information anonymously if you prefer. Or, you can send us an email at [taxshelter@ftb.ca.gov](mailto:taxshelter@ftb.ca.gov).

Abusive tax avoidance transactions are transactions promoted for the promise of tax benefits with no meaningful change in the taxpayer's control over, or benefit from, the taxpayer's income or assets. These transactions typically have no economic purpose other than reducing taxes, and may involve the use of multiple layers of domestic and foreign pass-through entities to complicate identification of the abuse. Practitioners often encounter these abuses or questionable transactions long before returns are even filed. Knowledge that the government is receiving early notification from the practicing community will greatly assist in deterring taxpayers from participating in these schemes. Information shared can assist in the identification and prosecution of those taxpayers who choose to participate in these abuses as well as those who are promoting them.

## Inside

**Calculate  
withholding  
allowances online  
page 2**

**Ask the Advocate:  
Fraud crackdown  
page 3**

**Do not overlook  
use tax  
page 4**

**Nonresident  
withholding news  
page 6**

**Practitioner hotline  
hours of operation  
page 7**

Find us online



[www.ftb.ca.gov](http://www.ftb.ca.gov)

## Tax News

Volume 05-1 January/February 2005

**Tax News** is a bimonthly publication of the Communications Services Bureau of the California Franchise Tax Board. Our primary objective is to provide information to income tax practitioners about state income tax laws, regulations, policies and procedures.

**Members of the Board:**  
Steve Westly, Chair  
State Controller

John Chiang  
Chair, State Board of Equalization

Tom Campbell  
Director, Department of Finance

Executive Officer:  
Gerald H. Goldberg

Editor:  
Marvin Meek

To receive a one-year subscription to the print version of *Tax News*, send a \$12 check or money order (no cash, please) payable to the Franchise Tax Board, to:

Tax News  
PO Box 2708  
Rancho Cordova CA 95741-2708.

*Tax News* is on the Internet at [www.ftb.ca.gov](http://www.ftb.ca.gov). Keywords *Tax News*. Subscribe to our *Tax e-News* email service today and start receiving all the latest news about the Franchise Tax Board. You'll receive frequent updates about laws and legislation, e-services, tax practitioner events, and updates on all the programs and services that are essential to the tax practitioner community. It's easy to subscribe or unsubscribe to *Tax e-News*.

To subscribe: Send an email message to [listservadmin@ftb.ca.gov](mailto:listservadmin@ftb.ca.gov). On the subject line, type the following phrase: "subscribe ftbtaxnews." Be sure to put a space between the two words and do not use quotation marks.

To unsubscribe: Send an email message to [listservadmin@ftb.ca.gov](mailto:listservadmin@ftb.ca.gov). On the subject line, type the following phrase: "unsubscribe ftbtaxnews." Be sure to put a space between the two words and do not use quotation marks.

### Need Help?

If you need help subscribing to any of our products or services, call the *Tax News* Helpdesk at (916) 845-7070 or send an email message to [taxnews@ftb.ca.gov](mailto:taxnews@ftb.ca.gov).

### Tax Practitioner Services

Our Tax Practitioner Support Unit is available from 8 a.m. to 5 p.m., Monday through Friday. Our telephone number is (916) 845-7057. You can send us a fax 24 hours a day, seven days a week. Our fax number is (916) 845-6377.

Hearing Impaired  
TDD (800) 822-6268

## Website offers new online version of withholding allowance certificate

If your clients are underwithheld each year or make estimated payments, and earn wages, consider having them take advantage of the new online version of California's Withholding Allowance Certificate (DE 4). It is an easier and more convenient method of computing the proper withholding allowances for state tax purposes and may eliminate the need to make estimated payments. Plus the DE 4 will compute the proper withholding for those families where both spouses earn income. You can find the online version of the DE 4 at [www.taxes.ca.gov](http://www.taxes.ca.gov) (search for DE 4).

## FTB gets two new board members

The California Franchise Tax Board has two new members. John Chiang, Chair, State Board of Equalization, and Tom Campbell, Director, Department of Finance, join Steve Westly, State Controller, to make up the three-member Franchise Tax Board.

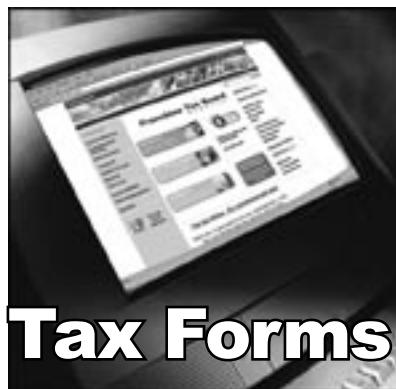
## Still time to order your 2004 Package X

We are still accepting orders for the 2004 California Package X. The printed version, bound or loose-leaf format, is \$18 plus sales tax.

If you did not receive a personalized order form either in your print version of the November/December 2004 *Tax News* or in the mail, go to our Website and download an order form. Here's how:

1. First access the order form by going to our Website at [www.ftb.ca.gov](http://www.ftb.ca.gov), and typing *Package X* in the search engine.
2. Complete the order form and follow the instructions provided. Be sure to add the amounts for your Package X and the *Tax News* orders, and apply the appropriate amount of sales tax to the Package X order based on where you live. Remember: Do not apply sales tax to the *Tax News* order amount.
3. Click the submit button.
4. Print the completed order form and mail it to us along with your check or money order.
5. For more information about ordering your 2004 Package X or subscribing to *Tax News*, visit our Website at [www.ftb.ca.gov](http://www.ftb.ca.gov) or call us at (916) 845-7070.

Remember: You can always get up-to-date versions of all our forms and publications on our Forms and Publications Website at [www.ftb.ca.gov](http://www.ftb.ca.gov).



**Updates  
available Online  
[www.ftb.ca.gov](http://www.ftb.ca.gov)**

**Tax Forms**

January/February 2005

# Ask the Advocate



**Debbie Newcomb**  
**Taxpayer Advocate**

Last summer we received several suggestions from you on how to close the tax gap (September/October 2004 Tax News). Some urged us to step up our efforts to investigate and prosecute bad tax preparers – those few bad apples in the industry who do not follow the rules and promote fraudulent ways for their clients to underreport income and overdeduct. And many of you felt we needed to use the news media more to publicize our enforcement efforts. Now, as part of a broader budget proposal under consideration by Governor Schwarzenegger, we may soon receive the resources we need to increase our efforts and crack down on fraudulent preparers.

If our budget proposal is approved, look for us to implement new enforcement strategies aimed at discouraging unethical tax preparers from doing business in California as well as deterring taxpayers from knowingly employing them. We are asking for enough resources to allow us to implement a program for assessing and collecting penalties on tax preparers who understate their clients' tax liabilities by adopting positions that have no realistic possibility of being sustained on their merits. We would assess these preparers a penalty of \$250 per fraudulent return.

In instances where we find preparers have willfully understated the liability for tax or have recklessly or intentionally disregarded a rule or regulation in taking a position on the return or claim, the penalty will be \$1,000 per return or claim. In all cases, once we determine that the tax preparers are knowingly filing false returns, we will audit the returns and issue assessments on their clients as well.

Regardless of the budget outcome, we will continually look for fraudulent tax activities. A key component to the effectiveness of our enforcement efforts is our ability to acquire good information to build a case. We continue to get good results from our information sharing agreements with other government agencies. We have access to wage and withholding information from the Employment Development Department, employers, and child care providers. We also receive tips from informants that help us identify fraudulent refund claims.

Our fraud detection activity in our *Child and Dependent Care Expenses Credit* Program is an example of how good information significantly improves the overall effectiveness of an enforcement program. We issued more than 20,000 letters to child care providers to verify taxpayers' entitlement to the *Child and Dependent Care Expenses Credit* for Tax Year 2003. With the information we received, we were able to identify a significant number of returns claiming unverified child and dependent care expenses, as well as the tax preparers who filed them. As a result of our investigations, we prevented the issuance of \$4.9 million in fraudulent refunds.

Even with fraud detection programs in place, the abuse of refundable credit claims continues to escalate, further contributing to the state and federal tax gap. In California, we estimate tax preparers file an estimated 56,000 returns with questionable child and dependent care expenses each year. The Internal Revenue Service estimates that 30 percent of federal *Earned Income Tax Credit* claims are fraudulent, leading to the issuance of between \$8.5 billion and \$9.9 billion in fraudulent refunds annually.

Expect to see and hear more in the news media about our investigation and prosecution of tax cheats as we attempt to heighten public awareness through increased media exposure of tax evasion charges, convictions or guilty pleas. We want to increase public awareness about the seriousness of the tax gap. Moreover, we want to educate taxpayers on how to recognize a questionable tax avoidance strategy and about the consequences for taxpayers and tax preparers who knowingly file fraudulent returns. You can read about all our tax gap proposals on our *Tax Gap Homepage*, located on our Website at [www.ftb.ca.gov](http://www.ftb.ca.gov).

---

## Subscribe to IRS' Exempt Organizations Update service

The Internal Revenue Service has a news service called the *Exempt Organizations Update*. Sign up now and receive email updates from the IRS about tax policy, services, and information impacting tax-exempt organizations, including:

- News releases from the IRS related to exempt organizations.
- New forms, guidance, and other related publications.
- Changes and additions to the IRS *Charities and Nonprofits Website*.
- Upcoming IRS training and outreach events.

To sign up to receive *Exempt Organizations Update*, visit the IRS Website at [www.irs.gov](http://www.irs.gov) and input *Exempt Organizations Update* into their search engine.

# Don't overlook use tax when preparing returns

Use tax is one of the least understood aspects of state tax law. California use tax law became effective on July 1, 1935. Section 6201 of the Revenue and Taxation Code established the use tax to eliminate the price disadvantage to California businesses when California consumers purchase taxable merchandise from out-of-state retailers. In general, taxpayers must pay California use tax on purchases made from out of state if the seller does not collect California sales or use tax, and the taxpayer uses, gives away, stores, or consumes the item in this state.

State Legislation passed in 2003 required

a use tax line to be added to California's income tax returns, making it easier for consumers to report and pay use tax on their purchases. Several other states allow taxpayers to report use tax on their state income tax returns.

In our analysis of individual returns from tax year 2003, we found that taxpayers who self-prepared their returns were nearly eight times more likely to declare use tax than those who used a tax practitioner. Nearly 63 percent of all individual returns we received were practitioner-prepared. Yet, only 16.6 percent of all use tax declarations were made on practitioner-prepared returns.

Please advise your clients about the possibility of having a use tax liability. For many taxpayers this new line added to our income tax returns is their first introduction to the idea of a use tax. If your clients have a use tax liability, advise them to report it on their California income tax return. It's easier and more convenient to report it to us than reporting it separately to the Board of Equalization.

Our income tax booklet instructions contain general information about the use tax and a worksheet to calculate the amount due. You may obtain additional information regarding use tax from the Board of Equalization at [www.boe.ca.gov](http://www.boe.ca.gov).

## Guidelines for claiming head of household

During this filing season many of your clients will inquire about claiming the head of household filing status. Although many taxpayers think of themselves as the head of their own household, they may not qualify for the head of household filing status under federal and state tax laws.

To qualify for this filing status the taxpayer must meet **all** of the following general requirements:

- The taxpayer was unmarried or considered unmarried on the last day of the tax year.
- The taxpayer paid more than one-half the costs of keeping up the home.
- The home was the main home for the taxpayer and a qualifying relative who lived with the taxpayer for more than half the year.
- The taxpayer was not a nonresident alien at any time during the year.

There are several reference sources to assist you in determining if your client qualifies for head of household. The 2004 personal income tax booklets for Forms 540/540A and 5402EZ contain the general rules for qualifying to use the filing status. For more detailed information see FTB Publication 1540, *California Head of Household*. This publication contains the general requirements, a detailed self-test, and

a section of definitions, as well as the answers to frequently asked questions. A companion publication, FTB Publication 1540SPAN provides the same information in Spanish.

You can also access the same comprehensive information on our Website at [www.ftb.ca.gov](http://www.ftb.ca.gov). By reviewing these sources and using the self-test to determine eligibility, most taxpayers can avoid a later denial of their head of household filing status, and an assessment of additional tax plus interest.

For your clients who file electronically,

we highly recommend that they also file a Form 4803e with their electronic return and answer a few questions regarding their qualifications for head of household status.

By filing a Form 4803e, most electronic filers can avoid later receiving a head of household audit letter. In recent years, the number of audit letters sent to taxpayers has steadily declined from more than 240,000 for tax year 1999 to less than 150,000 for tax year 2003. This has been a direct result of the increase in electronic filers and the success of the Form 4803e program.

## Assemble scannable tax returns properly to speed up processing

Follow these steps when assembling your clients' scannable Form 540. You will help us work more efficiently and speed up our processing of the tax returns.

1. If your clients have Forms W-2, use our new Schedule W, *California W-2 Attachment*, to help us keep track of them. To use it, attach paper copies of the Form(s) W-2s, W-2Gs, 1099, 592-B, 594, and 597 to the Schedule W instead of attaching them to the face of the tax return.
2. Leave the first page of the return loose. Do not attach anything to it.
3. Place any payments inside the envelope. Do not attach payments to the return.
4. Staple together the rest of the return; page 2, followed by Schedule W, then all other schedules and attachments in the usual order.



# Nonresident withholding: Be aware of key dates regarding annual returns and tax statements

If your clients withheld on nonresident independent contractors, royalty payees, partners, members, beneficiaries, etc., please note that Form 592, *Nonresident Withholding Annual Return*, and Forms 592-B, *Nonresident Withholding Tax Statement*, are due to payees and us no later than January 31, 2005, to avoid penalties.

The only exception is for withholding on foreign partners. Forms 592 and 592-B for withholding on foreign partners are due by the 15th day of the fourth month following the close of the partnership's or limited liability company's taxable year. If *all* the partners are foreign, Forms 592 and 592-B are due by the 15th day of the sixth month following the close of the partnership's or limited liability company's taxable year.

## Penalties for late filing

- Failure to provide correct Forms 592-B by the due date may result in penalties up to \$100 per Form 592-B.
- Failure to provide correct Forms 592-B to the payees by the due date may also result in penalties up to \$100 per each due Form 592-B.

## Flow-through rules

Pass-through entities such as partnerships (including limited liability companies classified as partnerships), S corporations, estates, and trusts may be required to flow through withholding credits.

- If a partnership or limited liability company was withheld on by another entity, that partnership or limited liability company can either allocate the entire withholding credit to all its members (residents and nonresidents) or claim a portion (not to exceed the total tax and fee due) on the *Nonresident Withholding Credit* line of Form 565, *Partnership Return of Income*, or Form 568, *Limited Liability Company Return of Income*, and allocate the remaining portion to all its partners or members.
- If an S corporation was withheld on by another entity, it can either:
  1. Allocate the entire amount to all its shareholders.
  2. Claim the entire amount on the *Nonresident or Real Estate Withholding* line of Form 100S, *California S Corporation Franchise or Income Tax Return*.
  3. Use a combination.
- If an estate or trust was withheld on by another entity, it should only claim the credit if it did not distribute the related income in the current year. If it did distribute the related income in the current year, it must allocate the credit to the beneficiaries.

## How to flow withholding through to partners, members, shareholders or beneficiaries

To allocate withholding credit to its partners, members, shareholders, or beneficiaries, a flow-through entity must file Form 592. Using the form for flow-through purposes usually requires completion of all parts on Side 1 except Part II, Tax Withheld. If the flow-through entity also carried out nonresident withholding on its nonresident partners, members, shareholders or beneficiaries, it would also need to complete Part II. If the flow-through entity was withheld on because it is a foreign partner, Side 2 should be used rather than Side 1. See Form 592 for detailed instructions.

Be sure to send the following with Form 592:

- A copy of the withholding document (Form 592-B, 594, or 593-B) from the withholding agent that withheld on the pass-through entity. Write *Tax Withheld by Another Entity* on the bottom of the document.
- Copy A of each Form 592-B that you prepare to allocate the credit to the pass-through entity's partners, members, shareholders, or beneficiaries. However, if the pass-through entity has 250 or more partners, members, shareholders or beneficiaries, you must use magnetic media. Get FTB Pub.1023F, *Nonresident Withholding Magnetic Media Guidelines*, for detailed instructions on filing using magnetic media.
- If the pass-through entity is claiming a portion of the withholding on its tax return, include a note stating the amount being claimed on the tax return.

## How to avoid late filing penalties

Pass-through entities required to file Forms 592-B need to be proactive to avoid late filing penalties. Contact the withholding agent now and ask to receive the withholding information early so the pass-through entity can file its forms by the deadline. If you do not get the necessary information in time, be sure to include a letter with the Form 592 documenting your request to the withholding agent and stating when the pass-through entity received the withholding document from the withholding agent.



## To attach or not to attach? Wrong decision can be costly

Processing tax returns containing unnecessary federal tax returns is a costly procedure, and so is processing those returns that lack the required federal tax return attached. In many instances we have to contact taxpayers and request that they send us their federal income tax return.

Both problems are significant because of their extremely high volumes. Most of you already instruct your clients on what to send us when they file. Please also explain to them how important it is to follow your instructions when they file, and to attach only what we require from them. As a general reminder, here are some guidelines for when to attach federal returns to California personal income tax returns (for filing purposes):

When filing:	Attach Federal Return?
540 2 EZ	No
540 with Schedules And B only	No
540 NR (Short)	No
540A	No
540 with any other schedules other than A and B	Yes
540 NR (Long)	Yes

If special circumstances exist and you're not sure of what documentation your client needs to provide us, please check the filing instructions on the tax form. You can find all our forms and related instructions on our Website at **www.ftb.ca.gov**. For a fail-proof way to ensure your clients are filing their returns properly, use e-file.

### Web Pay

Web Pay is the fast, safe, and efficient way for your clients to pay their personal income taxes online.

With Web Pay, your customers can make the following types of payments online:

- Estimated tax.
- Bill.
- Return.
- Extension.

**www.ftb.ca.gov**

## Real estate withholding forms undergo changes

Please note the following form changes for real estate sales closing on or after January 1, 2005:

### Form 593-C, Real Estate Withholding Certificate

- Both individuals and nonindividuals will use Form 593-C, *Real Estate Withholding Certificate*.
- Nonindividuals will now use Form 593-C to self-certify whether they are exempt from withholding.

### Form 593-L, Real Estate Withholding Computation of Estimated Gain or Loss

- Nonindividuals may now use Form 593-L to determine if they will have a loss on the sale.

### Form 593-W, Real Estate Withholding Exemption Certificate and Waiver Request for Non-individual Sellers

- We have eliminated this form. It will no longer be available or processed as of January 1, 2005.

Use forms with pre-printed year 2005 for escrows closing on or after January 1, 2005. For more specific information regarding real estate withholding, go to our *Sale of California Real Estate Webpage* located on our Website at **www.ftb.ca.gov**. To access the Webpage, type *real estate* into our search engine.

### Attention: Withholding forms have new post office box number

Effective January 1, 2005, some of our withholding forms have a new post office box number:

PO Box 942867

Sacramento CA 94267-0651

Please use the new address when submitting the following forms:

- Form 592, *Nonresident Withholding Annual Return*.
- Form 592-A, *Nonresident Withholding Remittance Statement*.
- Form 592-B, *Nonresident Withholding Tax Statement*.
- Form 593, *Real Estate Withholding Remittance Statement*.
- Form 593-B, *Real Estate Withholding Tax Statement*.
- Form 594, *Notice to Withhold Tax at Source*.

## Tax practitioner contacts and State holiday calendar

### Tax Practitioner Hotline

Telephone . . . . . (916) 845-7057  
Fax . . . . . (916) 845-6377

### Personal Income Tax Collection

Fax . . . . . (916) 845-0494

### Business Entities Collection

Fax . . . . . (916) 845-0145

### FTB e-Programs Customer Service

Telephone . . . . . (916) 845-0353  
Fax . . . . . (916) 845-0287

The Tax Practitioner Hotline is open Monday through Friday, 8 a.m. to 5 p.m. The Hotline is not open on weekends and state holidays.

### 2005 Official California State Holidays

Monday, January 17, 2005  
Martin Luther King Jr. Day

Monday, February 21, 2005  
Washington's Birthday (observed)

Thursday, March 31, 2005  
Cesar Chavez Day

Monday, May 30, 2005  
Memorial Day

Monday, July 4, 2005  
Independence Day (observed)

Monday, September 5, 2005  
Labor Day

Monday, October 10, 2005  
Columbus Day

Friday, November 11, 2005  
Veteran's Day

Thursday, November 24, 2005  
Thanksgiving Day

Friday, November 25, 2005  
Day after Thanksgiving

Monday, December 26, 2005  
Christmas Day (Observed)

## Practitioner hotline extends hours for amnesty

The Tax Practitioner Hotline will extend its operating hours during the 2005 tax return and amnesty application filing periods. The extended operating hours are as follows:

### Subscribe to Tax e-News today

When fast-breaking news about California taxation becomes available, *Tax e-News* subscribers are among the first to know and the first to act on behalf of their clients.

*Tax e-News* is free, and it's easy to sign up for. Go to [www.ftb.ca.gov](http://www.ftb.ca.gov), click on *Tax News Online*, and locate the *Subscriptions* Webpage. If you need help subscribing to *Tax e-News*, call the *Tax News Helpdesk* at (916) 845-7070.

Note: Make sure you add our *from* address (*CSBEmailServices*) and our title (*FTBTaxNews*) to your email address book (and to your safe senders list if you have one). This will prevent your *Tax e-News* from being swept up by an overly aggressive spam filter.

### Weekdays

February 1 through May 31, 2005

Monday through Friday

8 a.m. to 7 p.m.

### Weekends

February 5 through April 9, 2005

Saturdays only

8 a.m. to 4 p.m.

The Tax Practitioner Hotline will be available from 8 a.m. to 7 p.m. on the following holidays:

February 21, 2005,

Presidents' Day

March 31, 2005,

Cesar Chavez Day

The Hotline will be closed in observance of:

Martin Luther King Jr. Day,

Monday, January 17, 2005.

Memorial Day,

May 30, 2005.

Presorted  
First-Class Mail  
U.S. Postage Paid  
Sacramento, CA  
Permit No. 312

Address Service Requested

*Tax News*  
P.O. Box 520  
Rancho Cordova, CA 95741-0520